



CHEMONICS INTERNATIONAL INC.

Technical Assistance in:

**Legal Transformation and Limited Institutional Strengthening
for the**

THE CAISSE D'EPARGNE DE MADAGASCAR (CEM)

COMPLETION REPORT

Prepared for:

Democracy and Economic Growth Office
USAID/Madagascar
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USAID, Global Bureau, Office of Emerging Markets
USAID/G/EGAD/EM
SEGIR Financial Services Component

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ATTACHMENT 1 -- REVIEW OF WORK AND AVAILABLE TECHNICAL DOCUMENTS

1. INTRODUCTION

This Completion Report, as required under the terms of the Task Order, sets forth the following:

1. A review of work completed as well as a list of technical documents available upon request by the reader;
2. Findings of the Chemonics' team that relate to the components of the approved Revised Work Plan;
3. Conclusions and recommendations for the Caisse d'Epargne, which are related to the findings.

The Completion Report includes as Attachment 1 a table with a review of the work performed and a list of technical documents available to the reader upon request of USAID.

2. TASKS COMPLETED PER THE REVISED WORK PLAN / LIST OF TECHNICAL DOCUMENTS AVAILABLE

Attachment 1 sets forth a summary of the tasks completed under the Revised Work Plan, and lists the supporting technical documents made available. With the exception of 2 days of training in corporate governance, which was scheduled for September – October 2001, but which was cancelled because last-minute health problems caused the cancellation of travel by the team member who was to deliver the training, the tasks as set forth in the Plan were completed and advice and value delivered to the CEM as agreed. Yet for political reasons, the pace of the process of disengagement and related passage of enabling legislation and an implementing decree was slower than expected. This limited the Chemonics team's ability, within the time of the contract, to assist the CEM in assembling an application for a banking license, and in mobilizing and closing private investment capital. However, appropriate intellectual value was delivered, consensus on many parts of the process was achieved, and key relevant technical documents to enable implementation of the process were provided (notably a business plan and draft CEM by-laws and an implementing decree).

3. FINDINGS

Findings are set forth below, organized by segment of the Revised Work Plan (see Attachment 1) with the exception of the Training section of the Plan for which there are no separate findings.

3.1 LEGAL AND REGULATORY ISSUES

- Tangible progress was made with the passage and promulgation of a new enabling law for transformation of the CEM from a state agency (EPIC) into a joint-stock corporation (Société Anonyme). Malagasy counterparts demonstrated the political will to enable this, and CEM management was supportive throughout.
- Promulgation of a decree to allow implementation of the new law and so to complete the change in legal status will depend upon continuing political support, especially as counterparts must now review and decide about the details of the process of disengagement, strategies that have been recommended, an appropriate category for a banking license, and proposed by-laws for the CEM.
- Counterparts in the Malagasy government and at the CEM were very receptive to the technical assistance provided, accessible, and willing to implement those ideas that made good sense and on which there was common agreement.
- Legal transformation and the introduction of private capital are part of an involved, interrelated process that includes licensing and regulatory considerations, strategic decisions about the direction of the CEM, the drafting of a detailed business plan, resolution of tax issues, and preparation for the Commission de Supervision Bancaire et Financière (CSBF) of an application for a banking license. The file for CSBF will contain elements not originally contemplated by the Chemonics team and therefore not included in the Work Plan, for example credit and operations manuals for CEM. However, the team did address most elements required for an application to the CSBF, and assistance and draft documents were provided. Most important in this effort was a detailed draft business plan with financial projections.
- Despite the team's persistent efforts, there still remains ambiguity in two important areas, which could affect the timing of the disengagement process and the attraction of investment capital: choice of licensing category for the CEM, which is a unique institution in Madagascar; and CEM's possible income tax liability for past years as an EPIC, or state entity. With respect to the former, the matter can be settled feasibly, and strategies were studied and suggested to counterparts. For the latter, an innovative strategy was elaborated that can obviate any issue or concern if agreed at the political level.

3.2 INSTITUTIONAL STRENGTHENING

- CEM management and staff are of good faith and actively collaborated in efforts to strengthen internal systems and operations. Concrete progress was achieved in the implementation of Delta audit recommendations with the practical assistance of the team and the result that the CEM achieved its first unqualified audit opinion for fiscal year 1999 in accordance with international accounting standards. Continuing use of external auditors is needed by the CEM in view of its pending partial privatization.
- Key to improved internal financial control is the development and installation of a new information systems package. The Chemonics team assisted a parallel effort, also managed by Chemonics, to develop the terms of such a system under a related Task Order 806 and provided critical assistance in this area. The team emphasized that success in implementing any new package will depend upon needed additional work to clean up CEM's existing database prior to any changeover (the database has an error rate of 5-10%). As a result of this concern, adjustments may be made under the related Chemonics Task Order 806 to help ensure that this problem will be remedied.
- The status of management information available to, and used, by the CEM continues to need enhancement. New management performance yardsticks developed by the team have not been implemented.
- Ongoing capacity-building and training in the areas of operation and payments, information systems, credit, and bank management are needed.
- Rupture of CEM's relationship with the Post Office has hampered CEM's ability to maintain its reach to small savers in remote areas, its principal development mission. Expansion of CEM's branch network is planned to fill the void, based upon market studies to be conducted, and other complementary strategies and partnerships are being considered.

3.3 MICRO-FINANCE ACTIVITIES

- As a result of its substantial deposit base and long term sources of funds in Malagasy francs, the CEM occupies an important place in micro-finance in Madagascar: Its long-term liquidity would allow it to provide both funding and savings services to micro-finance institutions to assist their commercialization. The CEM's deposit base dwarfs the total amount of savings now collected in Madagascar by other donor-assisted micro-finance institutions.

- Other donors, especially the World Bank and the Fonds d'Équipement des Nations Unis (FENU), are increasingly interested in assisting the CEM and in cooperating with USAID in this effort. The team has been active in facilitating this coordination. In the case of the World Bank, a dialogue was been established in October 2001. As part of this process, based upon the Bank's interest, the CEM's needs for the Bank's possible assistance under its long-term micro-finance program in Madagascar will be identified and communicated for consideration. As for the FENU, a joint training seminar for the CEM was given in October 2001 with a team from the FENU in credit principles and in the refinancing of micro-finance institutions.

3.4 SALE OF SHARES TO THE PUBLIC

- This activity is dependent upon the issuance of a decree to implement the new law for the CEM – SA as well as upon the licensing process with the CSBF. As there has been a lag in these areas, no mobilization of capital was undertaken in accordance with the team's advice. However, the team has assisted with the structuring of this effort and provided a final draft of the principal fund-raising document, a detailed business plan (which may be easily morphed into an information memorandum or prospectus as needed, depending upon the audience).
- Private investor interest from institutions will be very limited by the small size of a potential transaction (in the case of foreign investors) and also dependent upon:
 - A schedule committed by the state to sell a majority of the shares within a reasonable period (as recommended by the team).
 - Protections for initial 34% minority shareholders in by-laws to be adopted by the CEM (so-called "blocking rights").
- Foreign investor interest is likely to be confined to officially sponsored entities because Madagascar's sovereign credit or "cross-border" risk is below investment grade. Moreover, the CEM does not represent a strictly "commercial" investment in view of its development mandate to accept small savings accounts that are not large enough to interest commercial banks, which means that a special type of investor will be required with objectives other than just a pure financial return. The Malagasy franc is also not freely convertible, which means that any foreign investor will require that an agreement be executed with the Malagasy state to allow for conversion of local currency into hard currency for remittance of dividends. .
- Of the various categories of investors discussed with Malagasy counterparts for the sale of an initial 34%, (a potential public share issue 10%, employee purchases of 5%, placements with institutions for the balance of 19%), the public share issue and purchase by employees are feasible. The balance of 19% can be placed privately

with a minimum of two foreign or local institutions (which may themselves have foreign ownership). Although local institutional interest will be in part constrained by prohibitions against new investments by Malagasy insurance companies, which are in the process of being privatized, other entities have evinced interest in taking a look at an investment in the CEM. A contact list of entities to be solicited has been provided to counterparts and is available to the reader of this report (see Attachment 1).

- A strategy for transparency in the pricing and sale of shares can be assured by offering a block of 10% to the public (see section above), then using this price as the offering price for shares to be placed separately with institutions. A commission associated with the CEM could be appointed which would select institutional investors from offers received according to transparent criteria.
- The sale of shares to private investors is closely related to the licensing process. For example, prior to granting a license, CSBF must review the identity of shareholders and specifically approve any holdings in excess of 5%. In turn, investors would not fund their investment subscriptions unless a license is obtained.

4. CONCLUSIONS AND RECOMMENDATIONS

- CEM should be privatized in two phases, with 34% sold initially and an additional 30% within a committed time thereafter. The 34% initial divestment would allow for the presence of private capital to enhance the CEM's governance, management, and operations for an interim period. The sale of the additional 30% in a second phase would shift control and management of the CEM into private hands, while the state would retain a substantial minority of 36% of the shares, in view of the public mission of the CEM. Protections for minority shareholders would be included in CEM's by-laws as recommended by the Chemonics team in draft documents provided.
- Continuing assistance should be considered to assure continuity and priority in the disengagement / privatization process, and to coordinate and provide assistance for capacity-building in the areas of credit, information systems, general management, and operations and payments.
- CEM should continue to solicit and obtain an external audit from a reputable firm each year in accordance with international accounting standards.

- CEM should proceed to procure a new information system in order to enhance internal control and management information systems available; however, it should not convert to any new system until its existing database is made reliable and cleansed for errors that would complicate any changeover and cause accounting irregularities.
- In addition to a planned expansion of its branch network, new partners and solutions should be researched and recommended to enable the CEM to continue to service those small savers who have been disenfranchised by the rupture in relations between the CEM and the Post Office.

**ATTACHEMENT 1 - REVIEW OF WORK AND AVAILABLE TECHNICAL DOCUMENTS
MADAGASCAR CEM PROJECT T.O. 801**

<i>Task</i>	<i>Duration Intended</i>	<i>People</i>	<i>Status</i>	<i>Available Technical Documents</i>
Work on clarification of legal and regulatory issues to remove ambiguities	May 15 – June 30, 2001	FHD, WSC, OS/CL, LLF		
Identify issues re. implementation of new law <ul style="list-style-type: none"> • Specific legal issues • Regulatory issues 	May 15, 2000 – June 30, 2001	FHD, LLF WSC	Done	
Prepare assessment report re. legal status	July 28, 2000	FHD, LLF	Done	
Check list / action items for law as part of interim progress report	June 9-Jul 28, 2000	FHD, WSC	Done	
Draft legal documents or provide comment, to assist the CEM in eliminating ambiguities relating to its legal status, e.g., amendment to 95/019, possible decree attendant to 95/019, by-laws.	May 15, 2000 – Feb 15, 2001	LLF, FHD	Done	Draft implementing decree and by-laws (in French) as of October 2001 which were delivered to counterparts; also draft law and decree which were delivered to counterparts in November 2000.
Advise and assist with agreement in principle between CEM and Post Office, provide draft protocol d'accord for use by parties if applicable.	July 15 – July 31, 2001	FHD, WSC, LLF	Not done. Post Office ruptured relations with CEM as of July 1, 2001.	

Provide ongoing advice and knowledge as appropriate to the RFP and work plan with respect to CEM's possible application for a banking or operating license. Keep USAID updated on this process and its course.	May 15 – July 31, 2001	WSC, FDH, OS/CL	Done	
Institutional Development and Strengthening	May 15, 2000- July 31, 2001	KN, WSC, LC		
Check for progress against first Delta audit report and Chemonics Assessment Report and assist CEM as appropriate in closing exceptions in the reports.	May 15, 2000– July 28, 2000	KN, WSC, LC	Done	
Assist CEM as appropriate in follow-up and implementation of recommendations from second Delta audit report on 1999 statements, and in closing exceptions in this report. Follow-up on earlier team recommendations for internal strengthening. Review Chemonics Assessment report of 1999 and provide a memo to USAID summarizing findings.	March 10, 2001 – July 31, 2001	KN, WSC	Done. Memo provided to USAID as part of Progress Report. Work aimed at Delta audit primarily.	August 2001 check list and status re. follow-up to Delta audit report available in French.
Review CEM performance yardsticks for change and develop one additional	May 15 – July 28, 2000	WSC	Done	Memo available in English and French.

one for AID to track profitability / sustainability.				
Assess tax liability as EPIC and as SA and its impact on sustainability / profitability	May 15, 2000 – Apr 15, 2001	WSC, KN	Done	
Assist the CEM in compliance with IASC / CSBF accounting standards and requirements and recommend steps as appropriate.	May 15, 2000 – July 31, 2001	KN	Done	Comparative table of accounts available.
Provide input for choice of auditor and recommend terms of reference	May 15, 2000 – Jun 10, 2000	KN	Done	
Monitor audit work	July 12, 2000– February 1, 2001	KN (WSC, LC)	Done	
Ensure preparation of 3 year financial projections for business plan and do first draft of business plan	March 15, 2001- April 15, 2001	WSC, KN	Done	Financial projections available with final draft of business plan (see below).
Prepare interim and final reports assessing progress / status for institutional strengthening component	May 15, 2000 – August 31, 2001	KN	Done	Various reports and documents available in French.
Do inventory of USAID resources and commodities transferred to the CEM and provide report to USAID	September 30, 2001	KN, WSC		

Micro Finance Activities	May 15, 2000-Apr 10, 2001	WSC, JB		
Input for business plan about market and strategy	March 10 – April 10, 2001	WSC	Done	
Communicate with organizations and counterparts interested in micro finance and provide input and advice to USAID with respect to counterpart opinions as they might affect activities or strategy for the CEM and its institutional development.	May 15, 2000-July 31, 2001	WSC, JB	Done	Briefing paper available in French presented a donor meeting in May 01.
Training of CEM management and Board				
Summary training plan	July 28, 2000	WSC, LC	Done	
Ongoing training as part of advisory work	May 15, 2000–July 31, 2001	Team	Done	
Training in governance and general management in an SA legal environment (2 days)	July 1 – 30, 2001	FHD	Not completed. Consultant not available for health reasons.	
Training in principles of financial management and control (2 days)	Apr 1 – 13, 2001	KN, WSC	Done	

Training in principles of credit management (2-3 days)	Apr 1 – 13, 2001	WSC	Done but abbreviated to 1 day.	Training pre materials provided
Assist CEM with Sale of Shares to the Public	May 15, 2000 – July 31, 2001	OS/CL, WSC, LC		
Develop consensus with counterparts at CEM and GoM about the structure of minority shareholding and the identity of potential strategic and local investors.	March 10, 2001 – July 31, 2001	WSC, OS/CL	Done	Concept or “Schéma” document in French
Prepare list of potential foreign strategic investors and visit with a selected few.	March 10 – April 10, 2001	WSC	Attempted visit with Caisse d'Épargne de Poitou-Charentes (France) but management not available. Conference call instead. Visit with investment fund in DC, local institutions by team	List available in French
Provide final recommendations about prospective strategic investors to CEM and USAID for follow-up	June 30, 2001	OS/CL	Done. Mostly local investors, some foreign.	List provided.

Draft "Notice" for public offering and do final draft of business plan or prospectus as appropriate.	June 1 – 30, 2001	OS/CL, FHD, LLF	Business plan done in final draft form..	Business plan available in French.
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FHD= Dulles, WSC=Chase, KN=Nguyen, JB=Beckwith, OS=Shahenshah, CL = Chris Lundstrom, LC=Qualified Local Coordinator, LLF= Qualified Local Law Firm